

India: The Next Asian Economic Giant

Arvind Panagariya

NITI Aayog

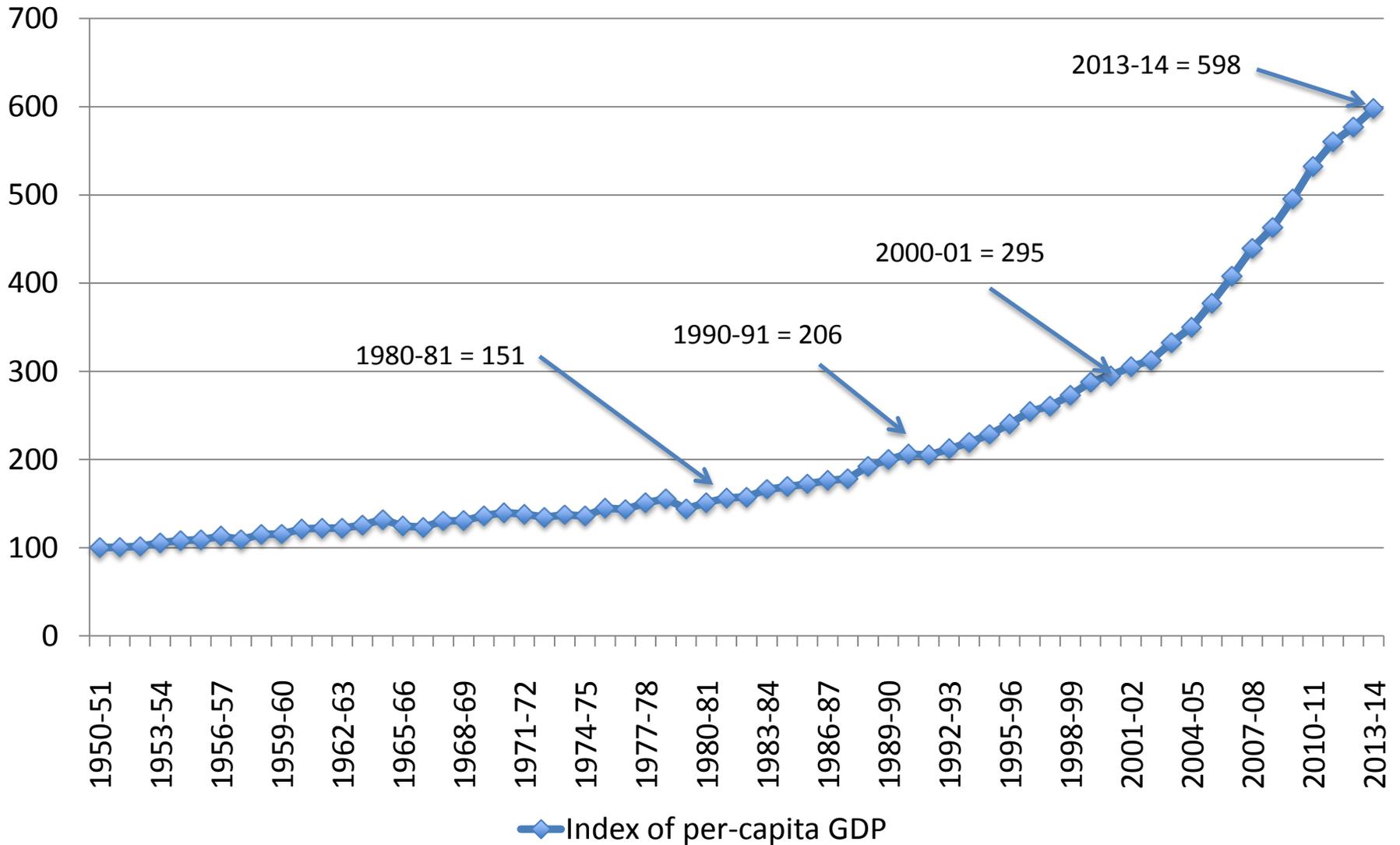
Government of India

POST INDEPENDENCE ECONOMIC HISTORY OF INDIA

Slow Growth has been Behind Slow Transform of India

Period	GDP	Per-capita GDP
1951-88	3.8	1.6
1988-2003	5.9	3.8
2003-012	8.3	6.7
2012-14	4.6	3.1

Index of real per-capita GDP (1950-51 = 100)



Where We Stand Currently

Annual growth in real GDP
2003-04 to 2011-12: 8.3%

Year	Real	2015-16 (Adv. Est.)	Real
2012-13	5.1	Q1 (April-June)	7.6
2013-14	6.9	Q2 (July-Sept)	7.7
2014-15	7.2	Q3 (Oct-Dec)	7.3
2015-16*	7.6	Q4 (Jan-March)	7.8

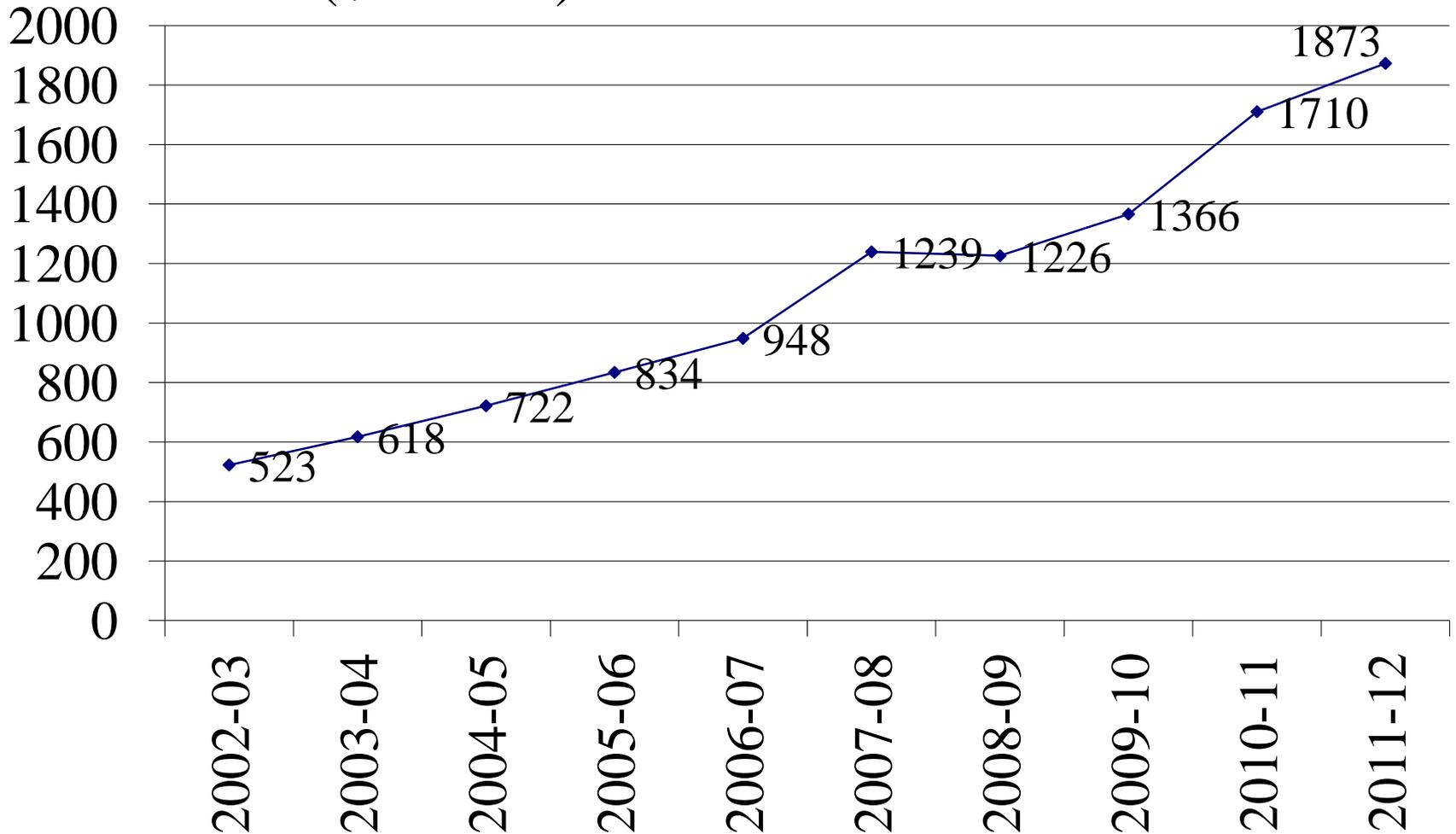
*Advance Estimate

India's Modernization Challenge

- After 65 plus years of development effort
 - Low per-capita income (\$1500 per annum in 2015)
 - High extreme poverty (22% in 2011-12)
 - Manufacturing stuck at 15% of the GDP
 - Low urbanization (31% in 2011)
 - Workers predominantly in informal employment
 - 50% in agriculture
 - Another 40% or more in the unorganized sector

INDIA'S VAST GROWTH POTENTIAL

GDP at market prices in current dollars (\$Billion): Annual Growth: 15.6%



India can be the Third Largest Economy in Fifteen Years

- Annual Growth in Nominal Dollars from 2003-04 to 2011-12: 15.6%
- With the GDP deflator 2% in USA, annual growth in India in real dollars during 2003-4 to 2011-12: 13.6%
- The GDP in 2015-16 in current dollars: \$2 trillion
- Conservatively assuming annual real growth of 10%, in 15 years, the GDP will be: \$8.4 trillion.
- **Therefore, becoming the World's third largest economy in 15 years is within India's grasp.**

What If Growth Stagnates at 5%

- At 5%, we will rise from \$2 trillion in 2015 to just \$4.15 trillion in fifteen years.
- This will leave India fourth or fifth globally, behind USA, China, Japan and possibly Germany
- The difference between a \$4.15 trillion versus \$8.4 trillion economy will be
 - Domestically, significantly poorer progress in cutting poverty and improving education and health outcomes
 - Internationally, much diminished relative to China

Why India has High Potential

- High Savings Rate
- A vibrant Entrepreneurial Class
- An Open Economy
- A Low Per-capita Income with Vast Scope for Catching up

Slow Transition from Agriculture to Industry and Services

- According to data for 2011-12, the share of agriculture in employment is 49% while that in the GDP is 15%.
- The best agriculture has done over a ten-year period is 4.7% during the 1980s.
- But industry and services grow 8-10% or faster.
- So the share of agriculture in the GDP will continue to decline
- **IMPLICATION: We MUST create good jobs in industry and services in much larger numbers so that farmers wishing to migrate out of agriculture may find employment at decent wages.**

Why the Focus on Labor-intensive Manufacturing is Important

- India has 500 million workers with another 10-12 million joining the workforce each year
- Except construction and retail, services will not create good jobs for low-skilled workers
- There is no known path to rapid transformation that does not go through labor-intensive manufacturing.
- Faster growth of manufactures helps create jobs in services as well.

Acceleration in Manufacturing Also Accelerates Services Growth

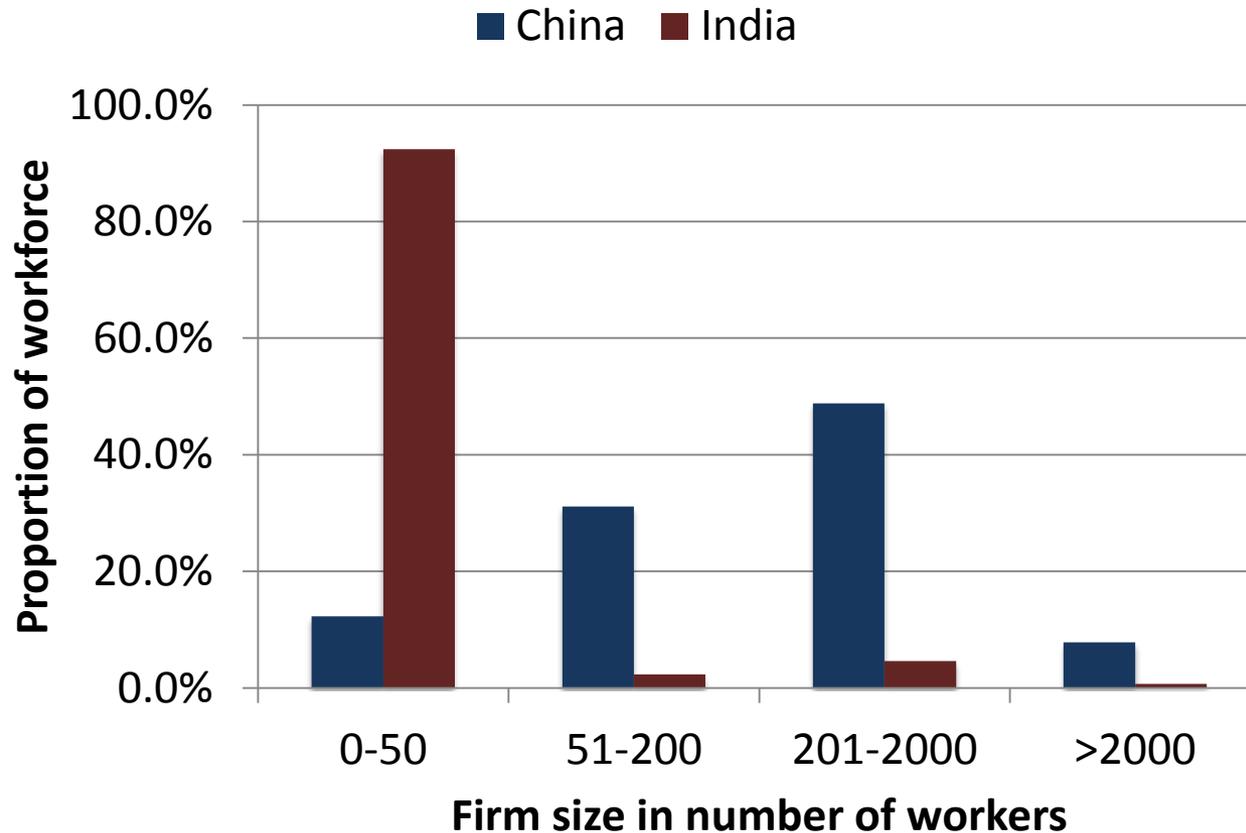
Country and period	Industry	Services
South Korea		
1954-62	11.6	4.4
1963-72	17.3	10.0
Taiwan		
1951-53 to 1961-63	11.5	7.6
1961-63 to 1971-73	15.3	10.3
India		
1991-92 to 2002-03	5.6	7.1
2003-04 to 2010-11	8.0	9.7

WHY HAS MANUFACTURING NOT DONE WELL IN INDIA?

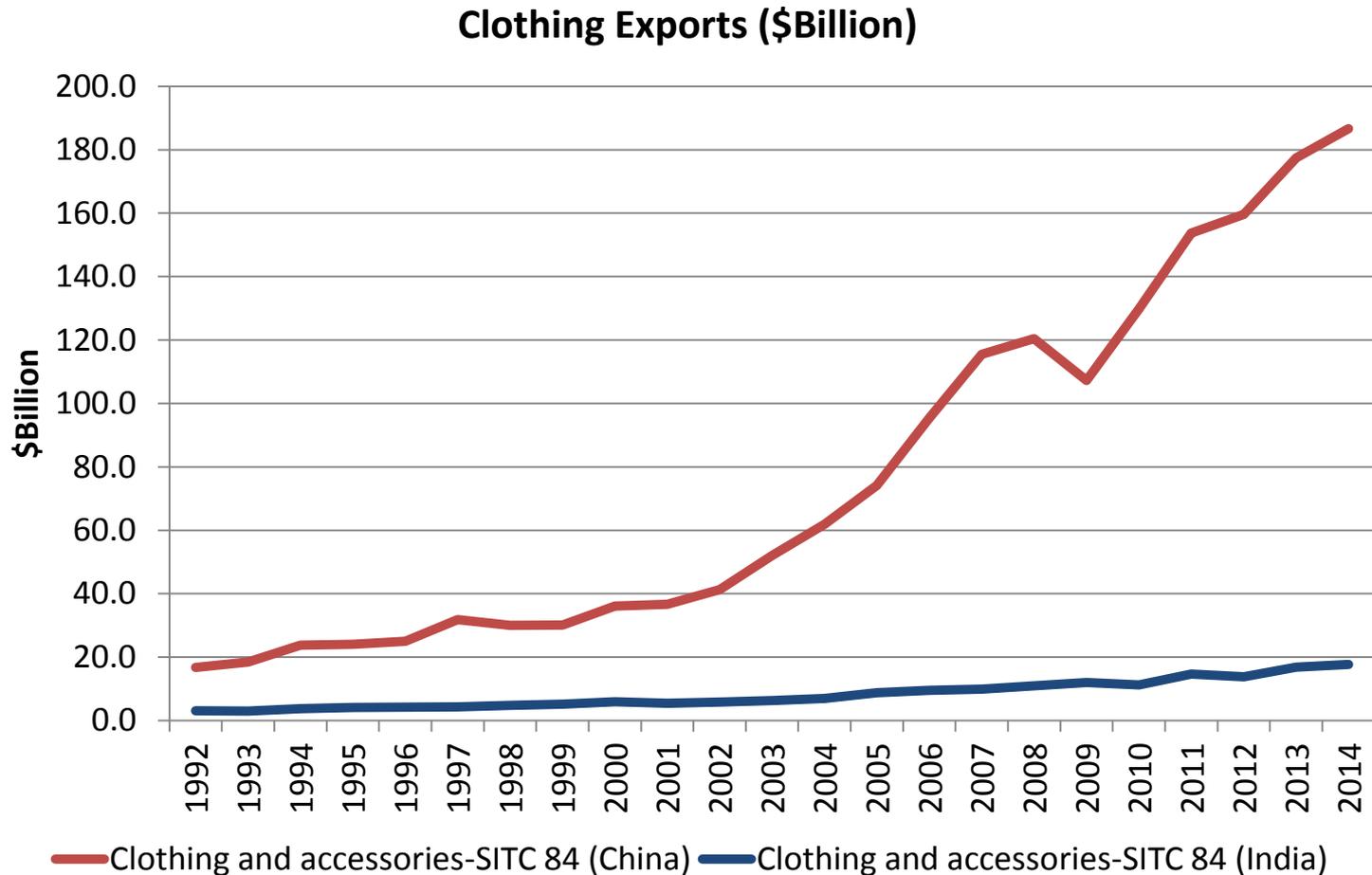
Substantial Presence of **Large-Scale Firms** is the Key to the Success in Manufacturing

- Per-unit costs decline with scale
- Large firms must sell in the world market
- Fierce competition in world markets forces these firms to rapidly adopt cost-saving technologies and management practices
- Small and medium firms also become more efficient as they become ancillaries to large firms or compete against them.

Apparel: Workers are in Small Firms in India, in Large Firms in China

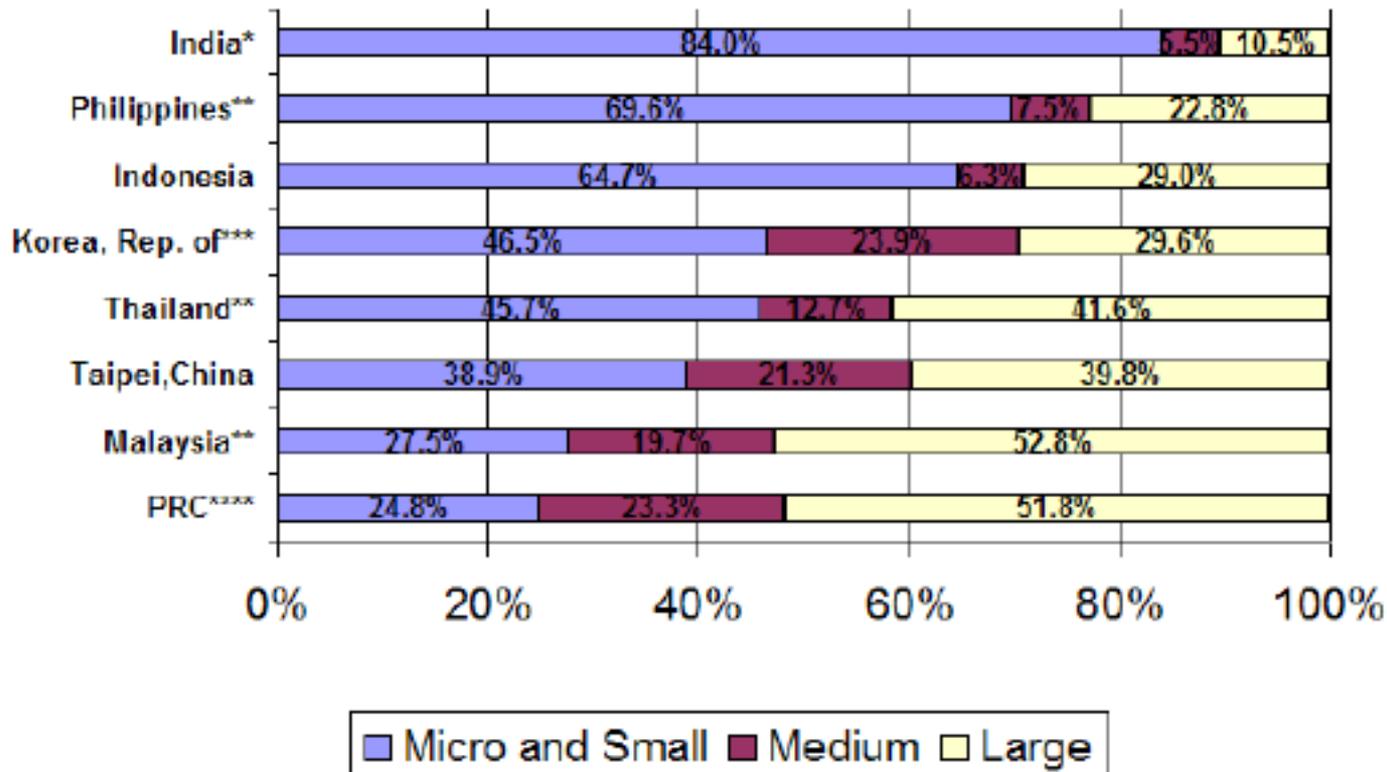


Export Performance in Apparel: India and China Perform Very Differently (1992-2014)



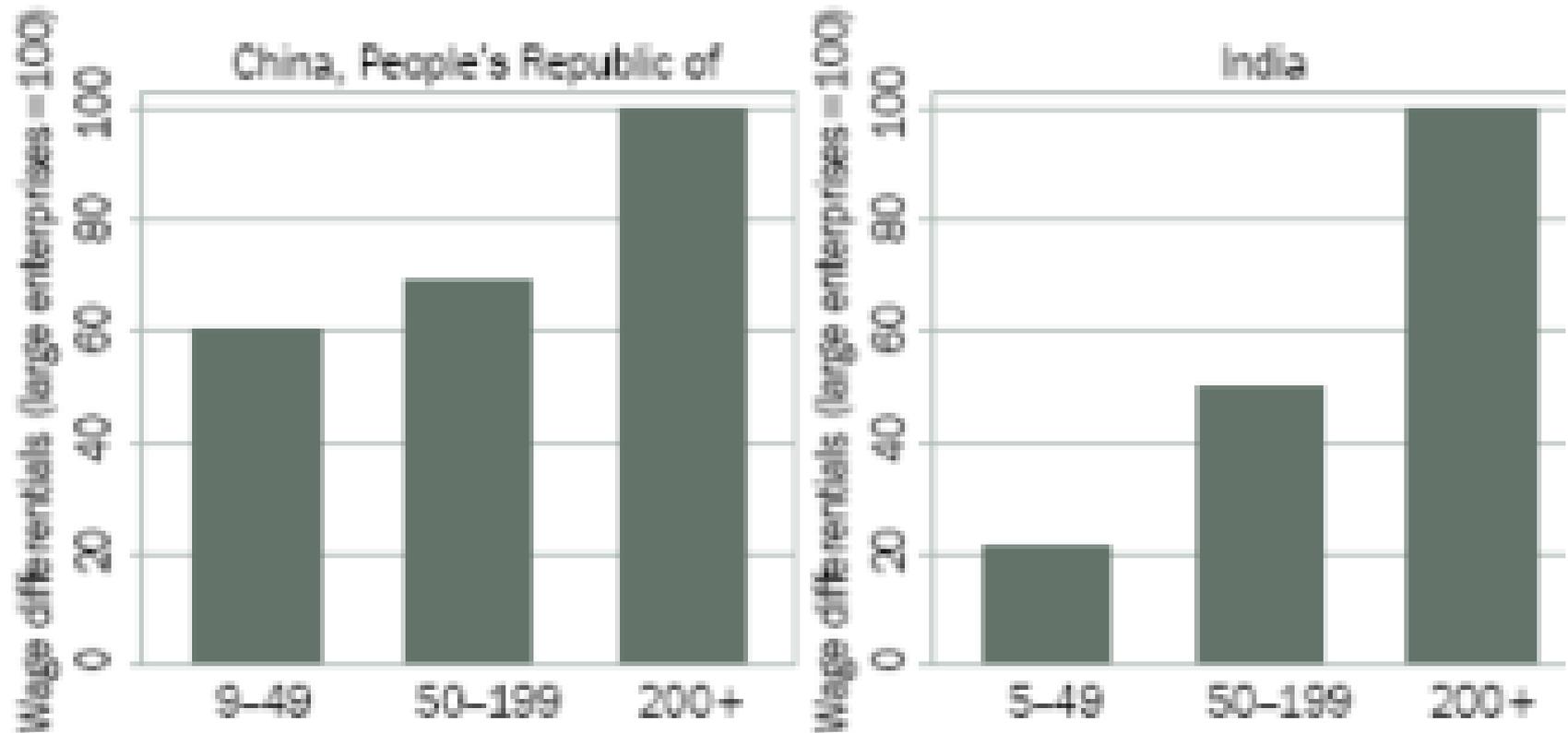
Make no Mistake, On Average, Indian Firms are Small

Share of Employment by Enterprise Size



Notes: Micro and Small: 1-49 workers in all countries except Thailand (1-50 workers); Medium: 50-199 in all countries except Thailand (51-200 workers); Large: 200 or more workers in all countries except Thailand (more than 200 workers)

Fewer Large Firms Translate in Low Productivity in Small and Medium Firms



The Overall Impact of Relatively Few Large Firms

- Low overall productivity because too many workers are stuck in low-productivity, low-wage micro and small firms
- In 2010-11, firms smaller than 20 worker
 - employed 73% of manufacturing workforce in India
 - But they produced only 12% of manufacturing output

THE PATH TO TRANSFORMATION STILL GOES THROUGH EXPORT-LED MANUFACTURING

Focus on Labor-intensive Manufacturing

- India has 470 million workers with another 10-12 million joining the workforce each year
- Except construction and retail, services will not create good jobs for low-skilled workers
- There is no known path to transformation in to to three decades that does not go through labor-intensive manufacturing

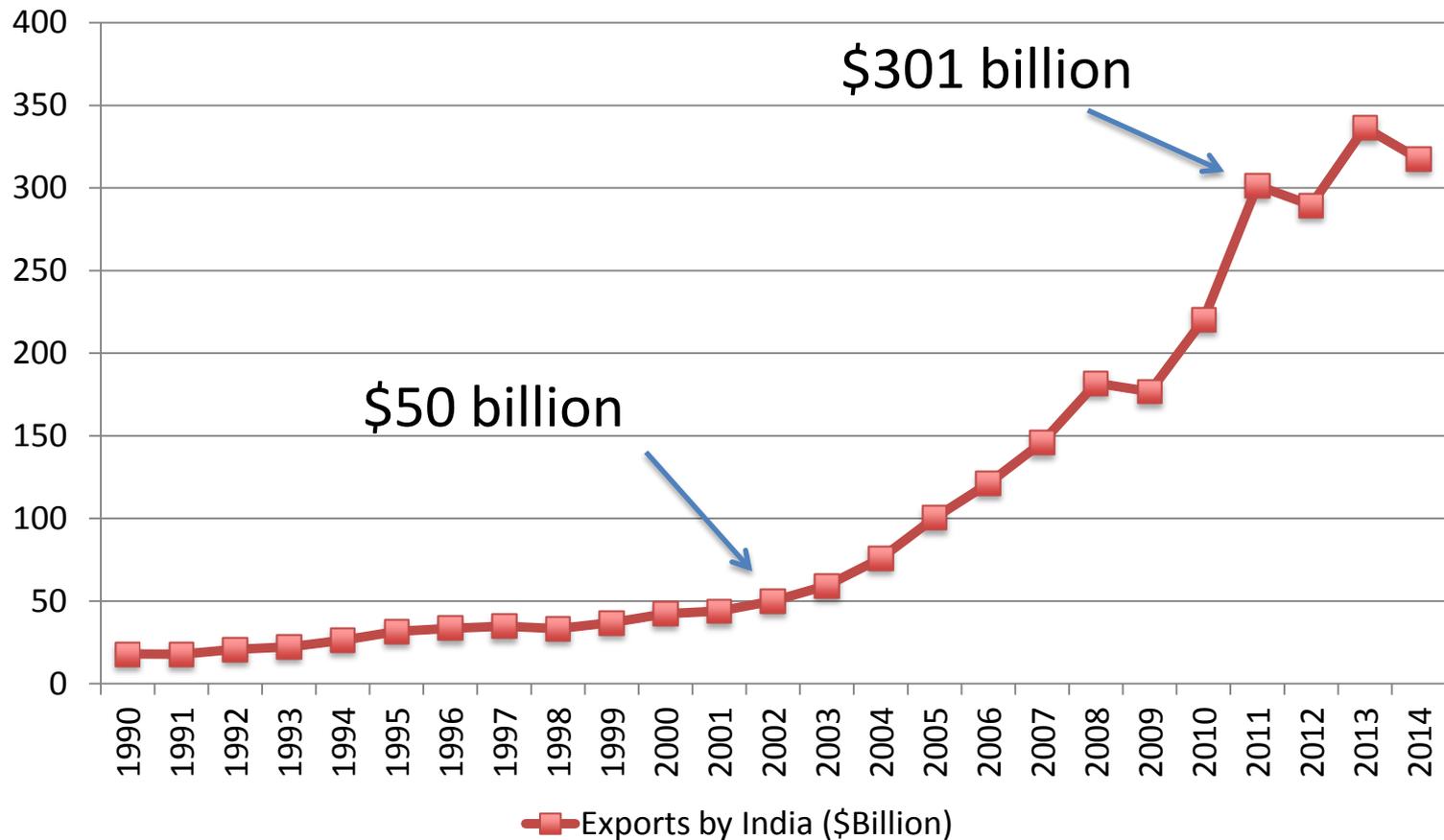
Export Orientation or Import Substitution?

- Cost competitiveness requires the presence of large firms.
- Large firms require large markets to sell their product. Large markets are outside, not at home
 - Total world merchandise exports: \$18 trillion.
 - India's domestic goods market: less than \$1 trillion.

 - India's domestic market in electronic goods: \$65 billion
 - Global market: \$2000 billion
- **Inevitable conclusions:**
 - Import substitution will not go far
 - We must go for the LARGE world markets.

Even India's 8.3% Growth from 2003-04 to 2011-12 Came with Rapidly Expanding Exports

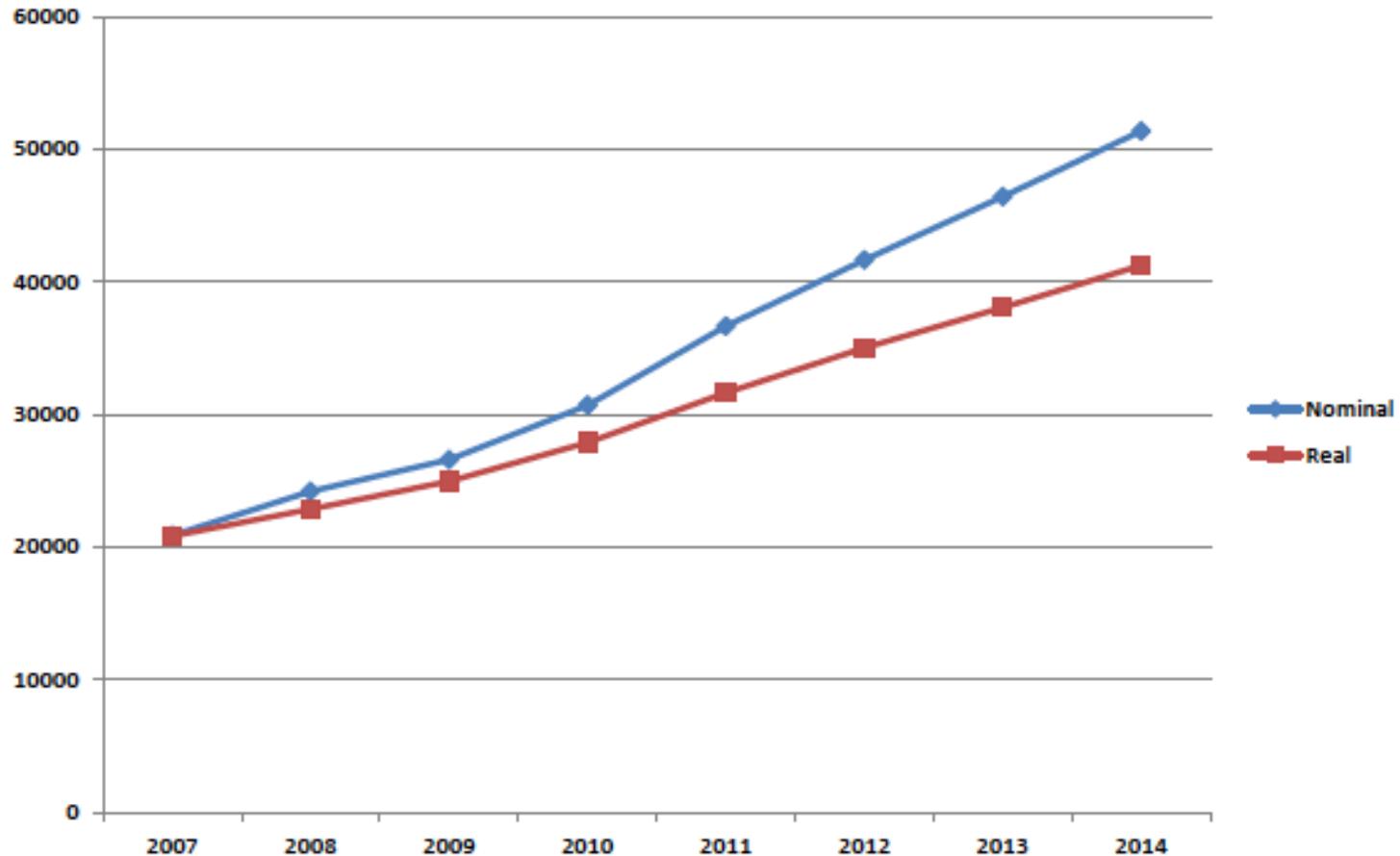
Exports by India: 1990 to 2014 (\$Billion)



But Can We Rely on Robust Export Growth in a Stagnant World Economy?

- Yes. Thus, consider that
 - Between 1995 and 2013, the OECD countries grew only 1.4% annually and yet China expanded its exports from \$150 billion to 2.2 trillion (share in world exports rose from 2.9% to 11.7%).
 - World merchandise exports today (2014) are \$18 trillion. We can grow by expanding our share from 1.7% today to 6% in 10 years.
 - Real wages in China are rising 10% per year since 2007 (Rs. 5 lakh annually currently). So China will vacate space in the world market in low-skill products.

Rising Wages in Manufacturing in China (Renminbi)



Source: Albert Park, Hong Kong University of Science and Technology [Annual Wages in 2014: Rs. 5 lakh. In surveys, Chinese firms point to labor costs as the most important barrier to their growth.]

But What About Robots and 3D Technologies Taking Over Manufacturing?

- Commercial viability of these technologies remains far off.
- In industries with job potential such as apparel, footwear, assembly activities and food processing, even scientific feasibility is some distance away.
- If the threat from robots were imminent, China today would be preparing for complete collapse. That it is not should tell us something.
- Rather than freeze out of these fears, we need to get going.
- This approach will also better prepare us for the age of robots should it become a reality.

A POSSIBLE STRATEGY

What India Must Do

- Taking the context of the ***Sagarmala*** initiative, a geographically focused, port-led development strategy must be pursued
- We must create **Coastal Economic Zones** that offer an ecosystem that is friendly to large, employment-intensive firms and sectors
- In CEZs, we must create infrastructure that allows goods to move in and out of the country rapidly
- We must build external trade alliances that ensure open markets abroad for our goods

At the Heart of the Strategy

- A handful of Coastal Economic Zones that
 - Encompass production clusters and urban centers
 - Are connected to selected deep draft ports on India's east and west coasts via a network of highly efficient logistics and distribution systems
 - Have a world class regulatory framework governing business, urban and industrial development
 - Are gradually connected to the hinterland through an ever expanding multi-modal transportation network